Running Up That Hill? The Challenges of Industrialization in the East African Community

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ABSTRACT *This article explores why the level of industrialization and manufacturing has remained so stubbornly low within the East African Community. The paper argues that the manufacturing sector's development is stunted because of a common set of factors – firstly, the international context is now extremely difficult for new players to enter into global manufacturing. Secondly, there has been a collective failure to actively implement industrialization policies. The paper concludes that the best option for the development of EAC industry is to focus on both 'recapturing domestic markets' and simultaneously exploiting better the potential of regional markets.*

KEYWORDS *EAC; manufacturing; regional integration; competitiveness*

Introduction

This article deals with the challenges to industrialization within the East African Community (EAC). By common consensus, the EAC is one of the more advanced regional blocks in Africa – certainly in terms of its ambition. At around 20 percent of its total trade, it has also achieved a relatively high degree of intra-regional trade, compared with intra-regional trade within many other African RECs (where the African average is about half as high).

Yet in one important sense, the region is failing. The level of industrialization is extremely low – and in four of the five member states has been on a declining trend. This is despite the fact that the *Common External Tariff* offers, by international standards, a relatively high level of protection to producers within the regional bloc.¹ And it is also despite a common policy toward incentivizing industrialization (the EAC Industrialization Strategy) (EAC, 2012).

This short paper argues that the manufacturing sector's development is stunted because of a common set of factors – firstly, the international context is now extremely difficult for new players to enter into global manufacturing. Secondly, there has been a collective failure to actively implement industrialization policies.

The paper concludes that, given the difficulties of entering into highly-competitive global markets, and the lack of prospects for a significant upsurge of foreign investments in the manufacturing sector, over the short-to-medium term the only realistic option for the development of EAC industry is to focus on both ‘recapturing domestic markets’ (a euphemism for the much maligned term ‘import substitution’) and simultaneously exploiting better the potential of regional markets, both within the EAC and the wider Africa region.

Why should manufacturing matter to the EAC?

The first question to ask is whether the EAC actually needs to industrialize. Different positions exist on the importance and role of manufacturing in development. The traditional view (as reflected in the work of Chenery, 1975; Kuznets, 1966) was that all countries undergo a structural transformation of their economies from agriculture, to manufacturing/industry and then toward services. In the 1980s and 1990s, in the period of structural adjustment, those ideas were generally abandoned, in favor of the proposition that the market would lead the way, and that the sectoral composition of GDP would sort itself out (Lal, 1985). In the end, that did not happen – countries of the region either remained stubbornly dependent on agriculture, or experienced a sharp increase in low value-added service and informal sector activities. It was not a recipe for rapid sustainable growth. Helped by a far more propitious external environment (the recovery of commodity prices, and substantial increases in both private capital flows and donor support), growth did finally resume in the region in the late 1990s and early 2000s, but a substantial degree of structural transformation toward higher value-added failed to materialize.²

More recently, however, the idea of the importance of manufacturing has reasserted itself in academic and policy circles (see UNECA, 2016 for a summary of these positions). There has been a renewed recognition that, without at least a

minimum level of industrialization and manufacturing, then rapid productivity growth and development would remain elusive. Some of the writings on this subject are becoming increasingly alarmist. In a recent article, Rowden (2015) claims that most of Africa has missed the boat in terms of opportunities to use this period of renewed economic growth to finance and fuel their industrialization. The writings of Rodrik (2014, 2015) also tend to concur with this, noting that Africa’s growth over the last 10–15 years has not been driven by export-led manufacturing. That is certainly the case for the East African Community – where all the countries in the region sustain large trade and current account deficits (Figures 1 and 2). As a result, countries in the region are running up against what Thirlwall (2011) coined as the ‘balance of payments constraint,’ whereby the economy cannot grow faster without engendering an un-financeable and unsustainable widening of the current account deficit.

Other economists still deny the validity of the proposition that manufacturing prowess is the solution. They argue that in the modern global economy, countries are no longer prisoner to slavishly following a single path to development and high incomes. Dadush (2015) has made this point eloquently, arguing that it is absurd for countries to invest an excessive amount of resources in a mad rush toward industrialization when many opportunities now exist to ‘leap-frog’

Figure 1: Trade deficits (millions USD) (2000–2014)
Source: WDI (2016)

Figure 2: Current account deficits (% of GDP) (2011–2014)

Source: EAC (2015)

that stage of development and move straight into higher value-added activities in the service sector. A number of governments with the EAC have been receptive to such thinking – most notably Rwanda, which, inspired by the Singaporean model, is pushing an expressly service-based hub strategy.³

This article takes a middle ground – that Dadush has some strong points, and that strategies like that of Rwanda to dynamize the service sector make sense. But we also argue that the EAC cannot collectively or individually afford to neglect the development of their manufacturing sector. A critical minimum level of industrial development is required if the region is to attain a sustainable rate of economic growth and development. Empirical studies specifically carried out on African economies like those carried out by Fosu (1990, 1996) confirm that episodes of faster growth on the continent have generally been associated with the stronger development of manufacturing sector and manufacturing exports. This makes sense because the tradability of manufacturing goods means that they help counteract the balance of payments constraints identified earlier.

At present, the region is underperforming on that score. UNECA (2015) estimates that from 1980 to 2013 the African manufacturing sector's contribution to the continent's total economy actually declined from 12 percent to 11 percent, leaving it with the smallest share of manufacturing in any developing region. Moreover, in most

countries in sub-Saharan Africa, manufacturing's share of output has fallen during the past 25 years. That is again the case within the EAC, whereby only one country (Uganda) has managed to buck the trend toward a smaller manufacturing sector in proportional terms, as we shall see in the following section.

Manufacturing on the wane? The current state of manufacturing in the EAC

It is actually surprisingly hard to get a coherent picture of the state of manufacturing across the region. Often a lot of inaccurate or misleading news is circulated about the 'manufacturing revival' of the region. The London-based newspaper *The Economist* for example recently reported⁴ that Tanzania was a relative success story, reporting that 'manufacturing output has grown 7.5% annually from 1997 to 2012' and that the country was 'wooing Chinese and Singaporean clothing firms and started building its first mega port and industrial park.'

Unfortunately, such anecdotal examples do not necessarily prove the case (there are similar initiatives across the region), and the statistic cited is misleading, in the sense that while the 7.5 percent figure is correct, it hides the fact that the economy as a whole has been growing at an even faster rate over the same period. As a consequence,

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Figure 3: Manufacturing as a % Share of GDP
Source: WDI (2016)

Tanzania, like four out of five of its EAC partner countries, has actually seen the manufacturing sector as a share of GDP contract over the last decade and a half (Figure 3).⁵

Another common characteristic of manufacturing within the EAC is that *the structure of manufacturing production is surprisingly similar between countries* – with food and beverages being responsible for between approximately half and two-thirds of all manufacturing (Table 1). The combined facts that, as a share of GDP, manufacturing seems to be contracting or stagnant, and that what manufacturing there is tends to be limited to a small range of

industries, suggests that the pattern is not random, but rather driven by a set of common constraints or factors.

Rodrik (2014: 11–12) has recently highlighted what some of those external constraints may be:

The reasons for this common pattern of premature deindustrialization are probably a combination of global demand shifts, global competition, and technological changes...Africa finds itself in an environment where it is facing much stronger head winds. Countries with a head start in manufacturing, having developed a large manufacturing base behind protective walls as in both Europe and Asia, make it difficult for Africa to carve a space for itself, especially as global demand shifts from manufacturing to services. Having liberalized trade, African countries have to compete today with Asian and other exporters not only on world markets, but also in their domestic markets. Earlier industrializers were the product of not just export booms, but also considerable amount of import substitution. Africa is likely to find both processes very difficult, even under the best of circumstances.

Empirical studies have tended to confirm this viewpoint. One particular competitive threat is Chinese manufacturing imports. Using disaggregated data for the period 1995–2005, Giovannetti and Sanfilippo (2009) found econometric support for the proposition that, with the intensification of economic relations, China has not only started flooding African markets with its low-cost manufactures – often at the expense of

Table 1. *Composition of manufacturing activity by main sector and employment share*

Industrial group	Kenya (2011)	Rwanda (2012)	Tanzania (no date)	Uganda (2011)*
Food, beverage & tobacco	39.7	72.4	57.0	52.0
Textiles and apparel	13.6	4.9	5.0	5.0
Tanning and leather	1.6	NA	NA	NA
Wood products, furniture, paper and printing	5.7	8.3	NA	8.0
Vehicles and M&E	3.5	NA	NA	NA
Other	35.9	14.4	38.0	35.0

Source: AfDB (2014).

Figure 4: Chinese imports into the EAC
Source: Comtrade (2016)

local producers – but has also begun to crowd-out cheap African manufactures in the region’s traditional markets (the USA and Europe).

The fact that the analysis of Giovannetti and Sanfilippo (2009) was carried out on data that are now ten years old suggests that the impact is now probably far more significant. Within the EAC, for instance, Chinese imports have risen from around 3 percent of total imports in 2000 to around 20 percent by 2014 (Figure 4). China is now the single leading trading partner for all EAC member states except Burundi. External factors like the competitive global environment, and the growing dominance of international value chains, are clearly important in explaining the weakness of the EAC’s manufacturing sectors. However, one element missing from this account is an assessment as to how well domestic policy interventions have helped counteract this admittedly difficult environment. It is to that we now turn.

An overview on the current state of industrialization policy within the EAC

In their economic development plans, all member states acknowledge the importance of achieving a greater degree of industrialization. But the route map of how to get there is less clear, in terms of

actually implementing industrial policy.⁶ At the regional level, too, there have been major policy initiatives. This makes sense, because arguably the size of domestic markets of the individual member states precludes the emergence of a strong manufacturing sector – in a global economy increasingly dominated by large economies and regional blocs, it is difficult to foresee the emergence of many viable firms if the strategy is limited to the national market. The EAC Industrialization Strategy (2012) is in principle the guiding framework. This includes some bold objectives, including:

- Diversifying the manufacturing base and quadrupling the local value-added content of resource-based exports to 40 percent by 2032;
- Strengthening national and regional institutional frameworks and capabilities for industrial policy design and implementation;
- Strengthening Research and Development (R&D), technology and innovation capabilities to facilitate structural transformation and upgrading of the manufacturing sector;
- Increasing the contribution of (1) intra-regional manufacturing exports relative to total manufactured imports into the region from the current 5 percent to about 25 percent by 2032 and (2) increasing the share of manufactured exports relative to total merchandise

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exports to 60 percent from an average of 20 percent; and

- (e) Transforming Micro, Small and Medium Enterprises into viable and sustainable business entities capable of contributing up to 50 percent of manufacturing GDP by 2032 (from 20 percent in 2012) (EAC, 2012).

The EAC Industrialization Strategy identifies six strategic sectors in which the region has potential comparative advantage including: (1) iron-ore and other mineral processing; (2) fertilisers and agrochemicals; (3) pharmaceuticals; (4) petrochemicals and gas processing; (5) agro-processing; and (6) energy and biofuels.

The principal problem is that the EAC on its own has no way of implementing the policies to achieve these objectives. Its own budget and resources are tiny.⁷ It thus depends on member states aligning their own visions with that of the EAC. At the moment, there are relatively few signs of significant alignment – indeed, member states generally view with some trepidation successes in manufacturing in neighboring states – fearing the competitive challenge that this could represent. The issue is not a minor one, either – as it was one important factor in the unraveling of the first EAC project back in the 1970s – the fear that the Kenyan manufacturing sector was disproportionately benefiting from the regional protocols.

There are also signs that the EAC is collectively becoming increasingly protectionist. Given the competitive climate both regionally and globally, this is completely understandable, but also somewhat ironic, since one EAC country (Uganda) was among the forerunners in adopting more liberal trade policies in Africa in the late 1980s. One long-standing illustration of the protectionist tendencies is the common external tariff of 25 percent on consumer goods imports (and a phased 10 percent on intermediate goods, and zero on primary goods). In principle, these are blanket tariffs, across all goods in these categories. In this sense, it goes against the principle of selectivity in industrial policy, singling out the most promising sectors for special ‘infant industry’ measures. But in practice exceptions are

made. For instance, Rwandan authorities have recently decided to increase the duty on imported leather products to 100 percent in the 2016/17 fiscal year, following repeated demands from investors that they need dominance of the local market. Similar measures have been implemented for similar reasons to ban the import of second-hand clothing.⁸

Another current trend is that the business sector is increasingly mobilizing support for preferential treatment with regard to government procurement. In a set of resolutions at a meeting as the first *EAC Manufacturing Business Summit*, held in Kampala in September 2015, regional manufacturers called upon ‘the government of East Africa Partner States and private sector...to prioritise in their procurement the sourcing of locally manufactured products including in agro-food, furniture, motor vehicles, apparels and footwear.’ They also call for a regional local content policy which clearly defines local and regional content to ensure that preferential treatment accorded to nationals is extended all suppliers within the East Africa Community (Sambo, 2015).

If well-executed, such efforts to prioritize local firms are to be welcomed. However, we need to bear in mind that similar policies have not necessarily been successful in the past. For instance, Uganda’s Tri-Star Apparels Company received significant incentives to export finished products to the USA under the AGOA trade regime, but the firm’s performance never met expectations.⁹

This brings home an important point – a weak private sector often makes it difficult to achieve the desired results. As confirmed by establishment surveys, EAC firms have on average very low productivity. By international and even African standards, East African companies also stand out for the small scale of their operations. According to the Africa Report’s (2016) annual rankings of the largest African companies based on sales (see ‘Appendix’), the EAC as a whole is home to just 21 companies ranked out of Africa’s top 500 companies. Out of these 21, the highest ranked company – *Total Kenya* – ranked only 78 out of the top 500. Notably, there are 11 Kenyan companies out of the 21 companies from the region; with only two

East African companies making it to the top 100 (Africa Report, 2016). Also notable is the extent to which mining, utility and ICT firms seem to dominate the list. Beyond the food and beverages, manufacturing firms are conspicuous by their absence.

Against such a backdrop, credible industrial policies will require a lot of state capacity, as authors such as Rodrik (2009) have been at pains to stress. There is now fortunately a general consensus between policymakers and across the development community on the basics that are required for successful industrial development, such as good infrastructure, a well-educated workforce and an efficient energy network. But even if a country manages to put in place these preconditions, manufacturing firms will not spontaneously emerge. The lesson from the recent literature is that industrial policy requires a lot of discretionary interventions. This can be very demanding on bureaucratic capacity. In addition, measures that may have worked back in the 1960s and 1970s, at the time of the emergence of the Asian 'tigers,' may have been superseded by events or no longer compatible with contemporary international trade and investment regimes. As Di Maio (2014: 562) stresses, 'industrial policy is back, but the world economy and the rules of the game have changed.'

Conclusions

If the overall tone of this article seems unduly pessimistic, it was not the author's intention. There are indeed a lot of promising developments across the region that could potentially facilitate greater industrial and manufacturing production. Firstly, vast improvements are being carried out in transport and energy infrastructure. In the past, the paucity of infrastructure represented a major bottleneck to industrial development. Secondly there is a growing awareness of the need in some sectors to 'recapture the domestic market' from manufactured imports. Encouragingly, initiatives to identify sectors where the potential exists to replace imports with domestic production are receiving significant donor

support through organizations like TradeMark East Africa. It is a welcome development that the donor community is gradually dispensing with the rhetoric that only a free trade regime will deliver the desired results, and recognizing that domestic capabilities need nurturing.

Thirdly, there are signs that the much discussed displacement of Chinese manufacturing firms to the region is beginning to occur. Ethiopia has generally been in the vanguard of this movement, attracting large-scale investments by manufacturing firms like Jiangsu Lianfa Textile in 2014 (worth 500 million USD). But there have also been recent investments by Chinese firms within the EAC, such as the Chinese-run C&H Garments in Kigali, and the proposal by Sichuan Wande Investment Group to spend up to \$400 million to set up an economic zone for Chinese firms in Uganda.¹⁰ Nonetheless, it is clear that the emphasis is still on Sino-EAC partnerships in the construction sector, rather than manufacturing.¹¹

Finally, the potential of *regional markets* for spurring the sustainable industrialization is fundamental – and the opportunities go beyond the EAC and extend to the wider African neighbourhood. Mold (2016) argues that the prospects for many high-income economies are not good – and that growth in the emerging markets is now faltering too. The prospects for export-led industrialization toward these traditional trading partners are correspondingly more somber. For this reason, it is important that intra-African trade opportunities are exploited to the full. There are multiple examples of thriving opportunities for intra-regional trade. In Kenya, for example, the furniture manufacturing industry primarily supplies the East African market, where rising urbanization and increasing purchasing power are likely to ensure robust demand in the coming years.¹² Similar strategies in other sectors should go beyond the EAC and extend to neighboring markets outside the EAC – with SADC, COMESA, and ECCAS.

In this sense, the EAC needs to collectively embrace what could be termed an 'African-centric open regionalism' whereby deeper EAC integration is not achieved at the expense of limiting exchange and interaction with other regional blocks in

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Africa. For instance, a study by Mold and Mukwaya (2015) suggests that, through the SADC-COMESA-EAC Tripartite Agreement, intra-regional trade could expand by a third, and the largest

beneficiary would be the manufacturing sector. In sum, it is time that the EAC countries gave due weight to both regional and inter-regional trade and investment opportunities.

Notes

- 1 Though there are exceptions, the standard tariffs stand at 25 percent on consumer goods, 10 percent on intermediate goods and zero percent on commodities.
- 2 See, for instance, the extensive empirical work measuring the pace of structural transformation carried out by Martins (2015).
- 3 It would be wrong to deduce from this that Singapore is a model of 'service-led' development....manufacturing played a very important part in the growth and development of the Singaporean economy. In addition, as a city-state, the fact that the country lacks any significant agricultural sector means that economic growth and development has not been tied down by the slower growth of a hinterland.
- 4 <http://www.economist.com/news/middle-east-and-africa/21677633-there-long-road-ahead-africa-emulate-east-asia-more-marathon>.
- 5 The only country to buck this trend is Uganda, and even there, recent developments suggest that manufacturing there is also contracting as a share of GDP (UNECA, 2016).
- 6 For two evaluations of industrial policy in the region (Kenya and Rwanda), see UNECA (2014). For a wider discussion of industrial policy in Tanzania and Rwanda, see Kelsall (2013).
- 7 The total EAC budget currently amounts to around 140 million USD a year, which is approximately 0.1 percent of regional GDP. This barely covers the running costs of the EAC Secretariat and associated institutions.
- 8 'Importers of use leather-goods decry higher taxes,' Rwanda Today, *The East African*, December 5–11, 2015; pages 1–4). 'Planned ban on second hand clothes unfeasible,' by Eric Kabeera, *The Independent*, April 17, 2016.
- 9 The failure in part explains why the used clothes industry in Uganda is booming in its position as a re-exporter of used apparel to Rwanda, the Democratic Republic of Congo and South Sudan.
- 10 <http://blogs.wsj.com/frontiers/2014/08/11/chinese-firm-plans-400-million-economic-zone-in-uganda/>.
- 11 In some cases, it also needs to be born in mind that the reported initiatives never actually get off the ground. For instance, a much-lauded industrial park in Uganda – 'Ssesamirembe City,' part of the 'Lake Victoria Free Trade Zone' – announced in 2008 as a 'transformative investment' never materialized. The investment, a partnership between a large Chinese firm and Ugandan investors, was to cover 500 square kilometers (200 square miles) of land and amount to some \$1.5 billion. The proposal included building a 'solar-powered' airport, manufacturing facilities and a distribution hub, as well as homes and agribusiness, all adding up to a new 'eco-city.' <http://www.economist.com/news/middle-east-and-africa/21678777-western-worries-about-chinas-burgeoning-influence-africa-may-be-overblown-not>.
- 12 <http://country.eiu.com/article.aspx?articleid=694034453&Country=Uganda&topic=Economy&subtopic=Regional+outlook&subsubtopic=Economic+growth>.

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Appendix

See Table 2.

Table 2. Largest East African companies in the African report top 500 firms in Africa

Rank	Company	Sector	Country	(a) Turnover (millions USD)	(b) Turnover change	(c) Net Profit (millions USD)	(a/c) Return on Sales (ROS) (%)
78	Total Kenya	Petroleum Services	Kenya	1850.7	5.1%	15.4	0.8
80	Safaricom	ICT/Telecoms	Kenya	1770.9	7.5%	345.5	19.5
110	Mohammed Enterprise Tanzania	Diversified	Tanzania	1278.2	NA	0.0	NA
125	Kenya Airways	Air Transport	Kenya	1194.1	-1.1%	-279.1	-23.4
145	KenolKobil	Petroleum	Kenya	989.9	-20.8%	11.8	1.2
210	Kenya power & lighting	Utilities	Kenya	678.6	24.3%	70.0	10.3
217	East African Breweries Group	Food and Drinks	Kenya	658.5	-2.1%	74.3	11.3
237	Tanzania Breweries	Food and Drinks	Tanzania	600.9	0.6%	121.3	20.2
275	East African Breweries Kenya	Food & Drink	Kenya	521.1	NA	NA	NA
309	MTN Uganda	ICT/Telecoms	Uganda	455.3	7.1%	NA	NA
345	Bamburi Cement	Construction	Kenya	390.6	1.1%	42.3	10.8
365	North Mara Gold mine*	Mining	Tanzania	365.4	NA	25.4	7.2
371	Umeme	Utilities	Uganda	352.0	-6.6%	NA	NA
373	Tigo Tanzania*	ICT/Telecoms	Tanzania	351.0	NA	325.7	94.5
376	Masumali Meghji Insurance Brokers	Insurance	Kenya	344.5	NA	NA	NA
425	Buzwagi Gold Mine*	Mining	Tanzania	284.2	NA	NA	NA
433	Bulyanhulu Gold Mine	Mining	Tanzania	279.4	NA	NA	NA
443	Airtel Tanzania	ICT/Telecoms	Tanzania	270.3	-0.2%	-83.0	-30.7
447	Jubilee Holdings	Insurance	Kenya	268.6	NA	33.6	12.5
489	Airtel Uganda	ICT/Telecoms	Uganda	230.0	NA	-19.6	-8.5
498	British American Tobacco Kenya	Agribusiness	Kenya	223.5	NA	42.4	19.0

Source: The African Report No. 77, Feb 2016.

* Data refer to 2014 company results.